

# Business in Brief

issued bi-monthly by the Economic Research Department

## THE CHASE MANHATTAN BANK



The advance in business activity continued throughout the second quarter. In the past year gross national product has increased more than 10% while industrial production has risen almost one-fifth. Such gains are typical of the recovery phase of the business cycle.

Now business has moved into the expansion phase of the cycle, and the rate of advance can be expected to slow down. As production moves closer to the limits set by the availability of manpower, materials and plant capacity, gains will be harder to come by. More immediately, a prolonged steel strike could place a drag on activity in the third quarter.

What is more, increases in production may become more selective in the period ahead. In fact, little further impetus towards over-all expansion can be expected from three major areas:

¶ Inventories were built up at an estimated annual rate of \$9 billion in the second quarter — about double a "normal" rate. If the steel strike is a lengthy one, inventory building might reach a comparable rate in the fourth quarter. Otherwise, the rate of accumulation seems likely to slow down.

¶ Federal expenditures are leveling off, and may show little increase in the coming year.

¶ Housing starts have been running at close to a 1.4 million annual rate for eight months. That's a high level in relation to basic demand and the availability of mortgage credit.

What, then, can sustain an advance in business? The answer is that most other areas of the economy are displaying increased vigor. Expenditures on plant and equipment are gaining momentum. State and local government spending is still on a rising trend. And consumer purchases have been moving steadily upwards.

Parenthetically, a sharp rise in consumer credit has helped support the increase in consumption. It has accounted for 15% of the total rise in spending, and equals almost 50% of the increase in sales of durable goods.

Taken together, the areas of possible continued expansion have five times as much weight in the econ-

omy as those that are level or tilted moderately downwards. Thus the economy seems poised for a period of normal expansion, though at a more moderate rate than that during the past year.

How will the steel strike affect these prospects? For an answer, consider first the impact of past steel shutdowns.

Experience in the 5 steel strikes during the postwar period shows that a shutdown lasting more than a week or two leads to growing unemployment in other industries. A loss of 6-8 weeks' steel output has brought the nation's metalworking industries to the point of widespread closings. Such strikes have resulted in dips of as much as 7% in total industrial production during the period when the mills were closed.

Serious as is the impact of a strike in these terms, its impact on the problem of containing inflation can be even more significant. Trends in steel prices and wages have had an important bearing on the inflationary problem. Steel is a basic material so that changes in its price affect costs in many other industries. And settlements in steel have set the pattern for wages over a broad segment of the economy.

Moreover, prolonged steel strikes have drawn down steel inventories to minimum levels, resulting in shortages and a rush to rebuild stocks for six months or longer after the resumption of steel production. Thus, an atmosphere is created which favors price increases.

Consequently, the outcome of the steel strike can prove of crucial importance to the nation. A settlement along past lines — providing for wage increases of 8% a year and necessitating increases in steel prices — could contribute to another round of the inflationary spiral.

On the other hand, the current situation presents an opportunity to deal a telling blow to inflation. The challenge is to work out a settlement along lines that contribute to increased productive efficiency and avoid the necessity for a price increase in steel. If this challenge can be met, the nation will have made substantial progress towards the goals of economic growth, sustained high-level employment and price stability.

# INTEREST RATES MOVE HIGHER

On July 16, the United States Treasury announced it would pay 4% for one-year money. Not since the late 1920's has the Government found it so expensive to borrow. Moreover, Treasury borrowing in the longer-term area of the market is not possible at all, under present circumstances, unless Congress acts to lift the 4% ceiling on new bond offerings — a limitation imposed during World War I. Businessmen, home buyers, and local governments have also found interest costs mounting, in some cases to the highest point in 25 years or more.

Understandably, these signs of rising rates and credit tightness are a source of concern to many. But all too often, in the search for alternatives, the basic role of interest rates in a free economy is obscured. As a consequence, the inflationary dangers in schemes to stabilize rates by legislative fiat are sometimes overlooked.

## Interest Rates as a Balancing Mechanism

Interest rates, to a borrower, are the cost of spending beyond his income. To a lender, they are the reward for saving. Looked at broadly, the function of interest rates is to balance these costs and rewards, so that spending with borrowed money is matched by a willingness on the part of savers to part with the necessary funds. In the process, savers, by foregoing current consumption, free productive resources for use by borrowers.

In periods of slack business, potentially profitable investment opportunities are limited, and demands for borrowed money typically decline. As a result, savers (and the institutions to which they entrust their funds) cut their rates in competing for what business remains. The monetary authorities, by adding to bank reserves and thereby injecting new money into the system, may then appropriately reinforce that downward trend. For, by making the costs of borrowing cheaper, spending is stimulated, and unemployed resources — human and material — put to work.

But the case is quite different during a time of rising prosperity, such as the present. Now businessmen are actively seeking more funds to finance inventories and capital spending. Growing consumer confidence has stimulated sales of durable goods and, with it, demands for instalment credit. Mortgages are being sought in heavy volume to support the high rate of home building. State and local governments are borrowing in record amounts to finance schools, roads, and other projects.

On top of these demands, the Treasury has just completed financing an unprecedented peacetime deficit of \$12.4 billion for the fiscal year ended June 30. And it must, for seasonal reasons, borrow another \$6-7 billion (net) over the six months ending December 31.

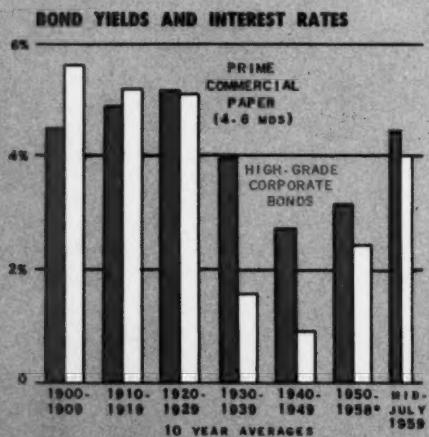
These borrowers, of necessity, have found themselves bidding against each other for lendable funds, even though the monetary authorities have permitted a moderate increase in the supply of money and bank credit. Those unwilling to pay the price — in the form of rising rates — must curtail their spending plans.

## Is There an Alternative?

The only alternative to this process of "rationing by price", without abandoning free credit markets, would be, in one guise or another, to inject large new supplies of money into the economy. But, real output can not be increased rapidly enough to satisfy the demands of all potential borrowers, and at the same time maintain levels of consumption. The net result would be that the borrowers, instead of bidding up interest rates, would find themselves bidding up the price of goods and services.

The causes of inflation in the United States are complex, and the cure does not lie solely in the financial area. But to discard policies of firm monetary restraint in pursuit of stable interest rates would only add further tinder to the smouldering fire.

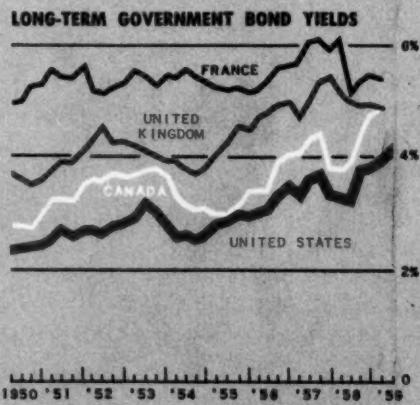
## INTEREST RATES IN PERSPECTIVE



Viewed in historical perspective, interest rates, while trending upward in recent years, have not reached abnormally high levels.

For instance, rates for both short-term commercial paper and long-term corporate bonds are below the 1900-1930 average.

Moreover, despite the relatively sharp rise in bond yields in this country over the past year, they are still lower than in most other leading countries.



# MEASURING PRODUCTIVITY

Productivity is in the news. It is one of the main items of debate in the steel wage negotiations. Its behavior is a major concern of the special studies under way by the Congressional Joint Economic Committee and the President's new Cabinet Committee on Price Stability.

While accurate measurement of productivity poses one of the thorniest economic problems, it is becoming increasingly recognized that productivity is the major source of improvement in our standard of living. There is much confusion, however, about what is actually meant by the term "productivity".

Most simply defined, productivity is a measure of the efficiency with which the nation's resources are used to produce goods and services. It can be measured in terms of output per unit of labor (or output per manhour as it is more commonly called), output per unit of capital, or output per unit of labor and capital combined. The last is the most comprehensive measure and indicates the productive efficiency of all resources. Recent studies of the private domestic economy by the National Bureau of Economic Research show that:

- Since 1889, the increase in productivity of labor and capital combined has accounted for about 50% of the nation's rise in output. The other half of the rise in total output came from the increase in the amount of labor and capital employed.
- Since the end of World War I, productivity has risen more rapidly and accounts for close to two-thirds of the gain in physical output.
- Even more striking is the fact that since 1919 the entire rise in *per capita* output — which indicates how much the standard of living has improved — has come from increased productivity.

## Another "New Era"?

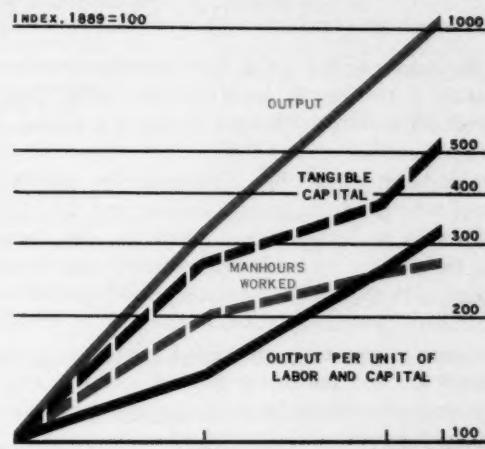
How do recent trends stand up against historical experience? In the 1948-57 period, total productivity rose 2.3% a year. This was considerably above the long-run annual average of 1.7% and slightly better than the more recent 1919-57 period. We produced \$22 billion more goods and services in 1957 than we could have if productive efficiency had risen at the long-run rate.

Interestingly enough, the postwar rise in *output per manhour* was well above the 1919-57 rate, while *output per unit of capital* actually declined. The reason for these divergent trends lies in the vast postwar investment in capital equipment. The stock of capital assets in use increased almost 40% between 1948 and 1957, while manhours rose only 4.5%. The rise in output per manhour, then, largely reflected the gain in efficiency which came from using more capital.

Does the good postwar record mean that we are on the threshold of a new productivity era? Many observers

## PRODUCTIVITY: HOW THE PAST AND PRESENT COMPARE

In the 1948-57 period, output of the private domestic economy rose at an average annual rate of 3.6%, slightly above the long-run 1889-1957 average. About one-third of the postwar gain in total output came from the increase in the amount of labor and capital employed. Two-thirds is accounted for by productivity — output per unit of labor and capital combined — which bettered its long-run record and rose at an average rate of 2.3% a year.



DATA: NATIONAL BUREAU OF ECONOMIC RESEARCH

felt so until a noticeable slowdown in the rate of gain set in from mid-1955 to mid-1958. The setback, however, appears to have been largely cyclical. From 1955 to 1957 the economy was operating at close to capacity and the plant and equipment boom of these years was not yet paying off in increased efficiency. Then, from mid-1957 to mid-1958, the recession was a dampening factor on productivity. Significantly, as recovery got under way, productivity advanced rapidly, raising hopes that a high rate of improvement in productivity can be maintained.

Recent experience again underlines the basic relationships among productivity, wages and prices. When wage rates rise faster than productivity, pressure is placed on prices. This was one of the factors behind the rise in prices from mid-1956 through mid-1958. This increase in prices washed out part of the gain in wages.

In other words, increased money wages alone do not signify economic progress. Rather, the key to a rising standard of living is improved productive efficiency. And greater efficiency can be achieved through improving our skills as workers and investing in more productive plant and equipment.

## GROWTH INDUSTRIES

What are the areas of growth in our economy? A recent Department of Commerce survey helps provide the answer. It covers production of some 300 items for which physical volume data are available since 1929, or since the first year of production. Of these 300 products or services:

- One-third are *fast growing* with output increasing at an average annual rate of 7½% or more; that is, over twice as fast as the long-term growth rate for the economy as a whole.
- One-half are *moderately growing* with increases of less than 7½% per annum.
- One-sixth are products with *declining trends*.

An inspection of the list of fast growing items shows that innovation is the key to rapid growth. More than half of the products with growth rates of 7½% per annum or more have been introduced since 1929.

The postwar period has witnessed the introduction of scores of new products from television and air conditioners in the 1940's to tranquilizers, transistors and transatlantic jets in the 1950's. In addition, research and development combined with aggressive marketing have opened new markets for such products as aluminum and plywood.

Growth rates typically are high in the early years of development of a successful new product and then drop as production expands. Many products go through a "life cycle" of: 1) rapid growth in the period when the product is securing universal adoption, 2) maturity in the period when growth is in line with the increase in population and consumer incomes, and 3) decline as some new product begins to take over the market. However, there is no one pattern of growth that is typical for all products.

### Sustained Growth

Chemicals and air transportation are examples of industries where high growth rates have been sustained for long periods. Research and development have played an important role in both cases.

The growth of the chemicals industry has been marked by development of a wide variety of new products. A McGraw-Hill survey elicited the fact that two-thirds of research and development expenditures of the chemical industry are on new products. By 1961, 14% of the industry's sales should be products not sold in 1957.

Some chemical developments result in new products that generate entirely new markets. Polyethylene production, for example, has skyrocketed — output multiplied 460 times between 1948 and 1958. In many cases, new chemical products displace existing products. Thus, synthetic fibers have enjoyed rapid growth even though output of textile products as a whole has grown little faster than population. Synthetic detergents offer another case in point.

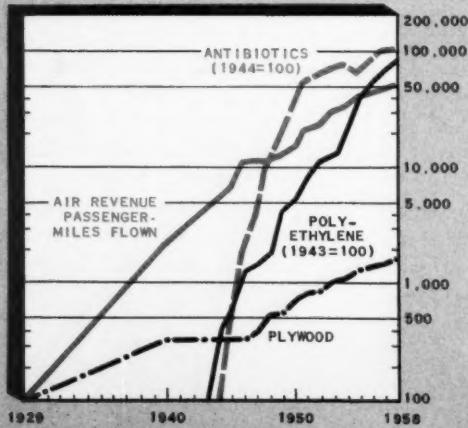
Air transport, an industry of commercial significance for only 30 years, has grown through steady expansion and improvement of its service. Passenger miles flown have expanded at an average annual rate of 25% since 1929, while air freight and helicopter service, though of much smaller dimensions, are moving up rapidly. Jet aircraft are now opening a new era of growth.

### Where Growth Has Slowed

Uninterrupted growth is not a universal characteristic of fast growing products. A number of such products experienced a noticeable slowing of growth in the past few years. In some cases, the easing may be temporary; in others it may mark a transition to a permanently lower rate of advance. Here are two examples:

- *Room air conditioner* sales rose rapidly from 1948 to 1956 when peak volume of 1.8 million units was reached. Then output sagged in 1957 and 1958. With only 12% of all homes equipped with air conditioners, sales could again show rapid growth.
- *Black and white television* was the most rapidly accepted of any major consumer durable good. In the first 13 years of large-scale production, 89% of all homes were

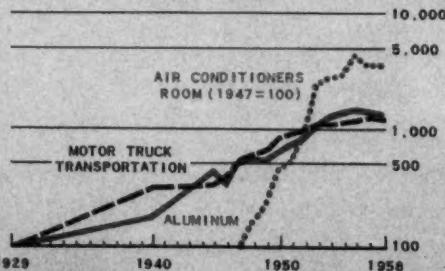
### CONTINUOUS EXPANSION ...



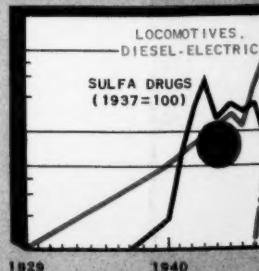
### PATTERNS OF PRODUCTION

#### PRODUCTS WITH HIGH GROWTH RATES — OVER 7½% PER YEAR — HAVE DIFFERENT PATTERNS OF GROWTH

##### GROWTH HAS SLOWED DOWN ...



##### GROWTH HAS BEEN CHECKED.



NOTE: RATIO SCALES - INDEX, 1929=100; WHERE OTHERWISE SPECIFIED, INDEX IS BASED ON FIRST YEAR OF PRODUCTION FOR WHICH DATA ARE AVAILABLE.  
DATA: DEPARTMENT OF COMMERCE

### 99 FAST GROWING PRODUCTS AND SERVICES

Average Annual Growth Rates — 1929-57 (or from first year production data are available)

10% and over	30% to 40%	20% to 30%	15% to 20%	10% to 15%
Transistors	TV Broadcasting stations	Effervescent wines	Urea resins	Freezers
Titanium sponge	Air ton-miles flown	Tractors, off-highway type	Locomotives, diesel-electric	Phthalic-anhydride
Power steering	Fibers, synthetic, ex. rayon	Polyvinyls resins	Xylene	Blouses
Power brakes	Dryers	Picture tubes, sales	Disposals, food	Acetic anhydride
Antibiotics	Coffee makers, automatic	Jet fuels	Automatic transmissions	Aircraft, civilian
Television sets	Argon	Air revenue passenger miles flown	Plastics and resin materials	Garden tractors
Polyethylene	Air conditioners, room	Pick-up hay balers	Perchloroethylene	Fibre drums
Styrene plastics and resins	Rubber or latex core mattresses	Blankets, electric	Distilled spirits	Aviation gasoline
Vitamins	Melamine resins	Helium	Paper milk containers	Sulfa drugs
Helicopters, nonmilitary	Dehumidifiers	Rayon and nylon tire cord	Magnesium	Dishwashers
Rubber, synthetic	Tape recorders, home use	DDT	Trailer coaches, mobile home type	Formaldehyde
Butadiene	Carpets and rugs, tufted	Lawn mowers, power	Skirts, separate	Phenol, natural and synthetic
Detergents, synthetic	Shavers	Ammonium sulfate, synthetic	Frozen foods	Transparent film for packaging
	Pentaerythritol		Coumarone-indene and pet. polymers	Ammonia, synthetic anhydrous
<hr/>				
7½% to 10%				
Wines	Shipping sack paper	Distillate fuel oil	Plasticizers	Clocks
Insulating board and hardboard	Oxygen	Ranges, electric	Mixers, food	Repairs, household durables
Acetylene	Glazed and unglazed wall and floor tile	Pipelines, oil	Methanol, synthetic	Nitric acid
Oil burners, residential	Rayon and acetate	Power sprayers and dusters	Canned fruit juices	Chlorine gas
	Calcium carbide	Hardwood doors	Photographs, single	Motor truck transportation
			Ice-making machines	Cellophane
			Phosphoric acid	Plywood
				Aluminum
				Water heaters, elec.
				Beer

equipped with television sets. Output of 7½ million sets reached in 1950 and not bettered again until 1955.

Growth rates for fast growing products thus vary widely. The nature of the products and the market condition the shape of the trend line.

The same is true for moderately-growing products. But here one finds that well-established products dominate the field and there is more of a tendency for the bulk of products to move ahead at a rate more or less in keeping with the trend of general business. Steel, cement, paper, automobiles and clothing are illustrative of major products whose growth trends are within striking distance of the economy's.

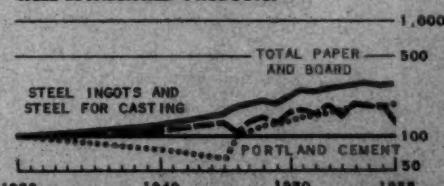
At the far end of the spectrum are products with long-run declining trends — the victims of changing technology or tastes. Thus steam locomotives gave way to diesels, travelers moved from railroads to airplanes and automobiles, nylon replaced silk in stockings.

Even in a growth economy, such declines must be expected as new and better, or different, products gain way. The excitement and challenge of growth is of course best conveyed by the rapidly expanding products where change is dramatic and rapid. But a dynamic economy will also have many products where growth is moderate as well as products whose production is on the decline. In a sense, these changes are one of the prices of growth.

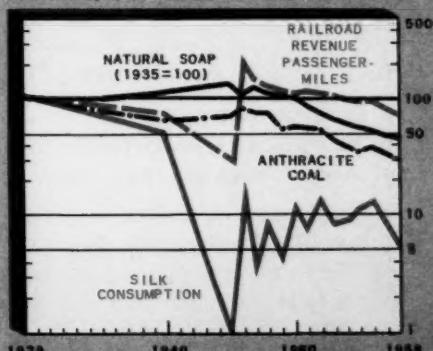
### IN THE AMERICAN ECONOMY

#### MATURITY OFTEN MEANS SLOWER GROWTH RATES FOR INDIVIDUAL PRODUCTS

GROWTH IS MODERATE — LESS THAN 7½% PER YEAR — FOR MANY WELL-ESTABLISHED PRODUCTS.



#### FOR SOME, THE LONG-RUN TREND IS DOWN.



# THE FOREIGN PAYMENTS DEFICIT

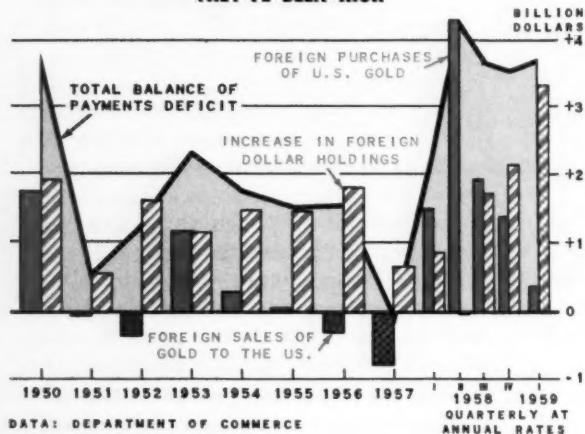
For the past eighteen months, the U.S. has been running a balance of payments deficit at a rate of over \$3½ billion a year. As a result, U.S. gold stocks have declined by some \$2.8 billion and foreigners have increased their short-term dollar assets by almost \$3 billion.

U.S. gold holdings were \$19.7 billion at the end of June — almost half the Free World total — so this deficit has not as yet resulted in any serious strain. However, a \$3½ billion a year deficit in overseas payments is clearly a larger amount than could be sustained for long. Thus two questions are posed: What factors have been responsible for the balance of payments deficit? What are the prospects that the deficit can be reduced to tolerable proportions?

These sources of dollars or dollar equivalents accounted for about 29% of total dollar earnings of foreign countries during this period. No nation in history has undertaken comparable responsibilities for the economic development and military security of other nations.

To be sure, not all the \$7 billion a year could be freely used by other nations. Roughly two-thirds of it was tied directly to U.S. exports. In other words, a reduction in U.S. aid would have meant an almost equal reduction in U.S. exports. But the remainder, \$2-3 billion a year, could either be spent freely on U.S. exports, kept in short-term funds in the U.S., or exchanged for gold or other currencies.

**U.S. PAYMENTS DEFICITS FLUCTUATE — IN RECENT QUARTERS THEY'VE BEEN HIGH**



For perspective in seeking answers to these questions, it is useful to consider the unprecedented character of the U.S. balance of payments situation ever since World War II.

In the 1953-58 period alone, even after Marshall Plan aid had been largely completed, the U.S. still spent an average of almost \$7 billion a year on:

- *Foreign aid* at a rate of \$1.9 billion a year (and, in addition, shipments of military items such as tanks and aircraft, which are not counted in our balance of payments, averaging \$2.9 billion a year).
- *Overseas military expenditures* at an average rate of \$2.9 billion covering construction and maintenance of overseas bases and troop expenditures abroad.
- *Private foreign investments* averaging \$2.0 billion a year. In addition, U.S. companies reinvested over \$1 billion a year from their earnings in foreign enterprises rather than returning this money as dividends.

## U.S. Export Surplus

Until recently, the U.S. export surplus was large enough to cover most of these out-payments. In the 1953-57 period, exports of goods and services exceeded imports by an average of \$2.7 billion a year. Thus, foreign holdings of gold and dollars were increased by \$1.7 billion a year, or by about the amount needed by other nations to sustain the growth in reserves required to support the expansion in their trade.

In the past few years U.S. aid and investments have risen rapidly, so that by 1958 the balance of payments was geared to an export surplus of over \$5 billion a year. But in the past eighteen months exports have dropped sharply, cutting the export surplus almost in half. This is obviously insufficient to support the responsibilities we have undertaken around the world. The choice is equally evident — either the U.S. must increase its overseas earnings enough to restore a tolerable balance in its overseas payments, or it must reduce the contribution to economic growth and military security of other nations below the scale of recent years.

In fact, with the general improvement of the economic position of many of our allies, it is possible that they may be able to assume a greater share of the burden of economic aid and mutual defense in the future than has been the case until recently.

## The Export Picture

What are the prospects of restoring a balance through an expansion in U.S. exports? As a rough estimate, an increase in the annual rate of commercial exports from the current level of about \$16 billion to about \$19 billion would suffice.

There are several developments in sight that point to the possibility of a pick-up in U.S. sales abroad later this year. Economic activity in Europe, Canada, Japan and some other countries has been rising noticeably after a leveling or moderate recession in 1958. Moreover, restrictions on dollar imports are being lifted in Europe as gold and dollar reserves reach higher levels.

While these factors cannot be expected to affect U.S. exports immediately, they could produce a substantial rise before this year is out. Already in sight is an increase in cotton exports at a rate \$300 to \$400 million higher than in the first half of the year. And shipments of commercial jet aircraft are expected to go up by an annual rate of about \$500 million starting sometime this fall — although part of these shipments will be made on credit. These increases add up to a little less than \$1 billion over the coming six months. More is clearly needed to bring U.S. foreign payments and receipts into reasonable balance.

### Trade Trends and Technology

The U.S., like most countries, tends to export what it produces most efficiently and import what can only be produced domestically at higher cost. But the pattern of relative efficiency changes constantly both in the U.S. and in other countries, so that the pattern of trade tends to shift. A recent study by the U.S. Department of Commerce analyzes this shift between 1953 and the 1st quarter of this year.

This study suggests which export categories are likely to grow most rapidly in the future. The study shows that out of 45 export categories, some 27 experienced increases of over 30%. These accounted for more than 55% of total exports. Moreover, exports in half these categories increased by more than 65%. More specifically:

- Exports of chemicals (including synthetic rubber), primary metals, aircraft, instruments, and fruits increased by more than 65%.
- Exports of coal, office equipment, auto parts, construction equipment, and radio and TV equipment increased between 35-65%.
- Exports of wheat, corn, cotton, trucks, buses and pharmaceuticals increased 0-35%.
- Exports of textiles, petroleum, passenger cars and tractors fell.

Several conclusions can be drawn from this brief analysis:

*First*, products with a very high technological component will be increasingly important in export trade. This includes certain chemicals and pharmaceuticals, aircraft, construction equipment, highly specialized instruments. Recent surveys show that expenditure on research and development is high in industries producing these items. So the U.S. is likely to remain very competitive in export markets for these types of products.

*Second*, products such as wheat, coal, cotton, in which the U.S. has large and highly efficient resources are likely to continue to be important export items, even though temporary surpluses abroad occur from time to time, as is the case with coal this year in Europe.

*Third*, increasingly heavy export competition has been

experienced on items where costs are rising in the U.S. (petroleum, automobiles) and where U.S. technology is not moving ahead rapidly (heavy chemicals, machine tools and most standard types of manufactured goods).

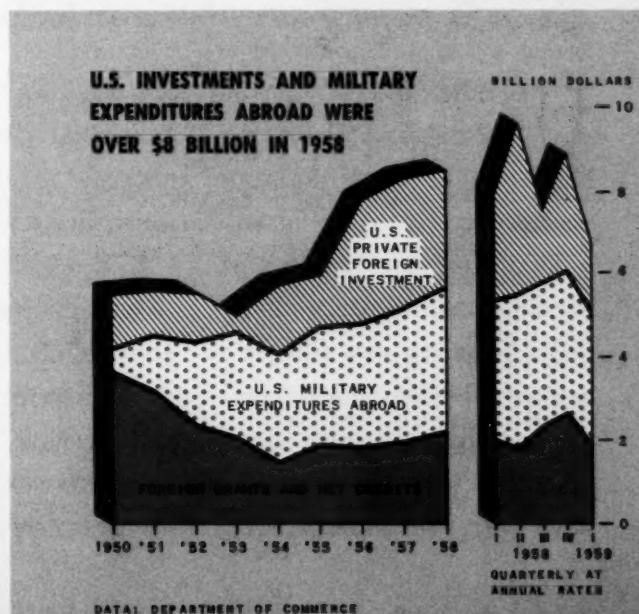
*Fourth*, about three-fifths of U.S. exports are included in categories with rising exports, indicating that the U.S. has remained very competitive on a wide range of products. Only one-fifth of the total has actually declined.

### Regaining the Balance

Some recovery in the demand for U.S. exports appears to be in sight as economic activity in other countries picks up, and as trade restrictions are lowered. The U.S. should be able to further expand exports of commodities in categories that cover well over half its shipments abroad. Providing inflation does not rob U.S. producers of their advantages in cost and product design, this should more than offset possible declines in the categories where U.S. competitive power has been on the wane.

Looking at the balance of payments as a whole, recent deficits do not signify that the U.S. is in a basically weak position in the international economy. Rather, it suggests that the \$65 billion spent by the U.S. Government since World War II to strengthen the Free World economically and politically is paying off. Country after country is achieving a good measure of economic growth, and to an increasing degree this is being combined with stability. In keeping with such trends, countries are finding it necessary to increase their holdings of gold and foreign exchange. In these circumstances, foreign dollar holdings will continue to increase, although at a slower rate than in the past year and a half. Combined with this, too, is likely to be some further outflow of gold.

There is no reason why the U.S. should not benefit from the general strengthening of the world economy. The challenge is to meet foreign competition in trade with vigor, continue to develop new techniques and new products for world markets, and hold inflation in check.





## A banker makes a decision

*a financial leader first, your banker is likewise a man of community affairs*

UMPIRING a close one on Saturday helps many a banker make wiser decisions on Monday.

That's because taking part in things close to the community's heart is a sure way for a banker to better know the people and their financial needs.

In that way, a banker can have both the understanding

and the insight to evaluate an individual's financial problem, counsel local businessmen, work wisely and profitably.

In a nutshell, a banker has to be a civic doer as well as a financial counsellor. By taking on community responsibility and learning what makes his neighbors tick, a banker makes his bank more useful every day.

When all's said and done, it's usefulness that makes commercial banking so important to the nation's economy and the American way of life.

THE  
CHASE  
MANHATTAN  
BANK  
Chartered in 1799  
Member Federal Deposit Insurance Corporation